

STATE OF ALABAMA
DEPARTMENT OF INSURANCE
MONTGOMERY, ALABAMA

REPORT ON EXAMINATION

as of

DECEMBER 31, 2001

of

ALFA MUTUAL INSURANCE
COMPANY

MONTGOMERY, ALABAMA

PARTICIPATION:

Alabama

EXAMINATION AFFIDAVIT

**STATE OF ALABAMA
COUNTY OF MONTGOMERY**


Rex H. Newborn being first duly sworn, upon his oath deposes and says:

That he is an examiner appointed by the Commissioner of Insurance for the State of Alabama;

That an examination was made of the affairs and financial condition of Alfa Mutual Insurance Company for the period of January 1, 1998 through December 31, 2001;


That the following 34 pages constitute the report thereon to the Commissioner of Insurance of the State of Alabama;

And, that the statements, exhibits, and data therein contained are true and correct to the best of his knowledge and belief.




Rex H. Newborn
Examiner-in-charge

Subscribed and sworn to before the undersigned authority this 16th day of July 2004.



(Signature of Notary Public)


_____, Notary Public
Printed name

in and for the State of Alabama

My commission expires 7/22/2006

TABLE OF CONTENTS

	<u>Page</u>
Salutation.....	1
Scope of Examination.....	2
Organization and History.....	2
Growth of the Company.....	3
Territory.....	3
Statutory Deposits.....	4
Holding Company and Affiliates:	
Holding Company Registration Reporting.....	5
Organizational Chart.....	5
Agreements with Affiliates.....	7
Corporate Records.....	8
Management and Control:	
Policyholders.....	9
Board of Directors.....	9
Officers.....	10
Committees.....	12
Conflict of Interest.....	13
Fidelity Bond and Other Insurance.....	13
Employee and Agents' Welfare.....	14
Reinsurance:	
Intercompany Reinsurance Pooling Agreement.....	15
Reinsurance Assumed.....	16
Reinsurance Ceded.....	17
Market Conduct:	
Plan of Operation.....	20
Policy Forms and Underwriting.....	21
Compliance with Agents Licensing Requirements.....	21
Advertising.....	21
Claims Payments Practices.....	22
Complaints.....	22
Privacy.....	22
Accounts and Records:	
Internal Accounting Records.....	23
External Audit and Actuarial.....	23
Financial Statements:	
Statement of Assets, Liabilities, Surplus and Other Funds.....	25
Statement of Income.....	27
Reconciliation of Surplus as Regards Policyholders.....	28

TABLE OF CONTENTS (continued)

	<u>Page</u>
Notes to the Financial Statements:	
Note 1 - Losses / Loss Adjustment Expenses.....	29
Note 2 - Premium Deficiency Reserve.....	30
Note 3 - Unassigned Funds (surplus).....	31
Contingent Liabilities and Pending Litigation.....	31
Subsequent Events.....	31
Compliance with Previous Recommendations.....	32
Comments and Recommendations	32
Conclusion.....	34

Montgomery, Alabama
February 20, 2004

Honorable Jose Montemayor
Chairman, Examination Oversight Task Force
Texas Department of Insurance
P.O. Box 149104
Austin, TX 78714-9104

Honorable Alfred W. Gross
Secretary Southeastern Zone
Virginia Bureau of Insurance
P.O. Box 1157
Richmond, Virginia 23218

Honorable Walter A. Bell
Commissioner of Insurance
Alabama Department of Insurance
Post Office Box 303350
Montgomery, Alabama 36130-3350

Dear Commissioner Bell:

Pursuant to your instructions and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners, an examination has been made of the affairs and condition of

**Alfa Mutual Insurance Company
Montgomery, Alabama**

as of December 31, 2001, at its home office located at 2108 East South Boulevard, Montgomery, Alabama 36116. The report of examination is submitted herewith.

Where the term, Company, appears herein without qualification, it is synonymous with Alfa Mutual Insurance Company.

SCOPE OF EXAMINATION

The examination reported herein covers the period from December 31, 1997 through December 31, 2001, and has been conducted by examiners representing the Alabama Department of Insurance. The Company's insurance affiliates (five property and casualty companies, and one life insurance company) have been examined concurrently with the examination of the Company. Events subsequent to December 31, 2001, have been reviewed as required and are reported herein as deemed appropriate.

The Company has been examined in accordance with the statutory requirements of the Alabama Insurance Code and the regulations and bulletins of the Alabama Department of Insurance; in accordance with the applicable guidelines and procedures of the NAIC; and in accordance with generally accepted examination standards.

The examination included a general review of the Company's operations, administrative practices and compliance with statutes and regulations. Income and disbursement items were tested for selected periods. Assets were verified and valued and all known liabilities were established or estimated as of December 31, 2001, as shown in the financial statements contained herein.

In compliance with requirements of the Alabama Department of Insurance, the President and Treasurer of the Company executed a letter of representation certifying that the Company had valid title to all its reported assets, and that it did not have unreported liabilities as of December 31, 2001.

Within this report, discussion of the Company's accounts has been confined to those items for which a material change in the financial statements has been noted or for which comments and/or recommendations have been made.

ORGANIZATION AND HISTORY

The Company was incorporated August 13, 1947 under the name, Alabama Farm Bureau Mutual Casualty Insurance Company. It was organized as a mutual insurance company by the Alabama Farm Bureau Federation (AFBF), to provide property and casualty insurance to the members of the AFBF.

Effective May 1, 1987, AFBF withdrew, as a franchise member, from the national Farm Bureau Federation and changed its name to Alabama Farmers Federation. The name of the Company was changed to Alfa Mutual Insurance Company.

During the interim from the Company's organization through 1987, the Company became affiliated with four other property and casualty insurers. In 1987 a reinsurance

pooling agreement was formed between these five affiliates. The terms of the agreement provide that all direct business of the affiliates will be ceded to the Company. The pooled business is then retroceded according to percentages provided in the pooling agreement. In 1989 an intercompany reinsurance pooling committee, representing the boards of directors of the reinsurance pool participants, was established. This committee is responsible for reviewing and approving any changes to the pooling agreement, to assure that transactions are fair and equitable to all pool participants, and to monitor potential, or actual, conflicts of interest between pool participants.

In 1999, Alfa Specialty Insurance Corporation (ASI) was organized as a wholly-owned subsidiary of the Company. ASI became a participant in the reinsurance pooling agreement in 2001.

No significant amendments to the Company's Articles of Incorporation or By-laws, or other events of an organizational or historical nature were noted during the examination period.

GROWTH OF THE COMPANY

The following schedule presents financial data, which reflect the growth of the Company for the years indicated:

<i><u>Year</u></i>	<i><u>Gross Premiums Written</u></i>	<i><u>Admitted Assets</u></i>	<i><u>Liabilities</u></i>	<i><u>Policyholders' Surplus</u></i>
1997	671,584,941	1,071,649,278	342,581,016	729,068,262
1998	684,456,401	1,062,266,630	279,914,361	782,352,269
1999	659,439,895	1,080,241,192	309,850,782	770,390,410
2000	668,824,197	1,132,080,327	349,567,911	782,512,416
2001	693,415,733	1,113,238,221	378,908,954	734,329,267

Data for the years 1997 and 2001 are per examination. Data for the remaining years were obtained from the Company's Annual Statements.

TERRITORY

As of December 31, 2001, the Company was licensed to transact insurance business in the following jurisdictions:

Alabama
Georgia
Michigan
Ohio
Virginia

Connecticut
Indiana
New York
Pennsylvania
Wisconsin

Florida
Massachusetts
North Carolina
South Carolina

The Certificates of Authority from the respective jurisdictions were inspected and found to be in effect at December 31, 2001.

STATUTORY DEPOSITS

In compliance with statutory requirements for transacting insurance business in the respective jurisdictions, the Company had the following securities on deposit at December 31, 2001:

Deposits Held for the Benefit of Policyholders, Claimants, and Creditors of the Company

	<u>Par Value</u>	<u>Statement Value</u>	<u>Market Value</u>
<u>Alabama</u>			
Compass Bank, U.S. Treasury Note, 7.625%, due 2/15/07	\$ 500,000	\$ 499,184	\$ 503,125
<u>Georgia</u>			
Wachovia Bank, U.S Treasury Note 7.625%, due 2/15/07	35,000	35,700	35,219
<u>Massachusetts</u>			
Fleet National Bank, U.S. Treasury Note, 7.625%, due 2/15/07	500,000	519,332	503,125
<u>North Carolina</u>			
Wachovia Bank, U.S Treasury Notes (two), 7.625%, due 2/15/07	75,000	77,900	75,469
<u>Virginia</u>			
Suntrust Bank, U.S. Treasury Note 4.75%, due 11/15/18	300,000	291,574	298,875
Totals	<u>\$1,410,000</u>	<u>\$1,423,690</u>	<u>\$1,415,813</u>

All statutory deposits were confirmed as of December 31, 2001, by written correspondence with the respective custodians.

Reinsurance Deposits

At December 31, 2001, the Company had securities pledged under security fund agreements relating to various reinsurance contracts. The aggregate values of said securities are as follows:

<u>Reinsurer</u>	<u>Par Value</u>	<u>Statement Value</u>	<u>Market Value</u>
American Agriculture	\$ 100,000	\$ 100,128	\$ 100,000
Berkley Insurance Company	11,010,000	10,503,887	11,390,634
Kemper Reinsurance Company	11,975,000	11,822,795	12,324,327
National Union Fire Insurance Company	18,155,000	17,777,166	18,185,521
NERCO	2,100,000	2,091,703	2,103,329
St. Paul Fire and Marine	24,685,000	24,371,710	25,198,742
Vesta Fire Insurance Company	82,000	81,655	81,655
Totals	<u>\$68,107,000</u>	<u>\$66,749,044</u>	<u>\$69,384,208</u>

HOLDING COMPANY AND AFFILIATES

Holding Company Registration and Reporting

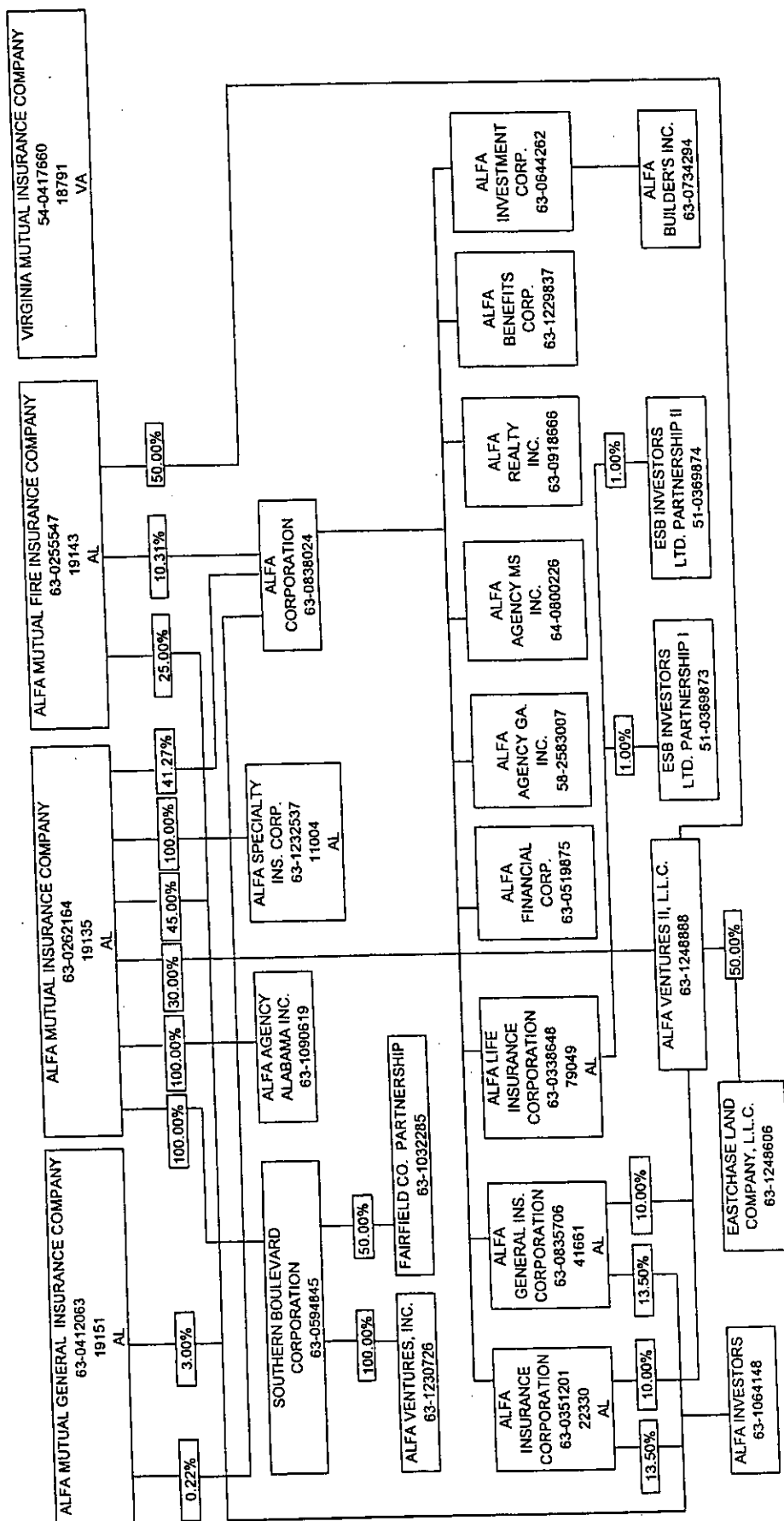
The Company is deemed to be subject to the Alabama Insurance Holding Company Regulatory Act of 1973, as defined in Section 27-29-1, *Code of Alabama*, 1975. The Company is responsible for holding company registration and periodic informational filings with the Alabama Department of Insurance, in accordance with Section 27-29-4, *Code of Alabama*, 1975, and Alabama Department of Insurance *Regulation Number 55*.

Holding Company filings and amendments to registration statements made on behalf of the Company and its affiliates, for the years under examination, were reviewed. Said filings and amendments were found to be substantially complete and to reflect the required disclosures.

Organizational Chart

The chart on the following page depicts the insurance holding company system with which the Company was affiliated as of December 31, 2001.

6



Agreements with Affiliates

Management and Operating Agreement

The following insurers were under the control of the Company and were parties to a Management and Operating Agreement with the Company: Alfa Mutual Fire Insurance Company; Alfa Mutual General Insurance Company; Alfa Insurance Corporation; Alfa General Insurance Corporation; and, Alfa Specialty Insurance Corporation. These companies will be referred to, collectively, as the "affiliates" in the remainder of the discussion of this topic.

This agreement has been in effect since January 1, 1960, with periodic amendments to modify the terms and to add companies as they became affiliated. Effective January 1, 1990, it was revised to continue on an annual basis through December 31, 2001. After that date, the agreement has been extended for additional periods of one year each.

Pertinent terms of the agreement include the following:

- 1) The affiliates designate the Company to take charge of, conduct, operate and manage the business of the affiliates, respective to each affiliate's charter and Board of Directors, and in a manner conducive to the profitable operation of each respective affiliate. The Company will provide all home office operating service to the affiliates, including accounting, disbursement and payroll services and will serve as a disbursing agent for the payment of all employees and agents of the affiliates.
- 2) The Company agrees to employ, in its own name, all personnel necessary to perform the aforesaid, and reserves all rights and responsibilities of the employer of said personnel. All agents of the affiliates shall be appointed in the name of the respective affiliates and shall work on behalf of the respective affiliates. All personnel and agents of any affiliate employed outside Alabama are the sole responsibility of that affiliate. The Company also agrees to indemnify and hold the affiliates harmless against any loss on account of the dishonesty or infidelity of any of the Company's employees.
- 3) The Company agrees that the business of each party to the agreement shall be conducted in the name of the respective party and that the records of each party shall be kept separately. The Company agrees to provide all required records, record-keeping services and data processing necessary to the efficient and economical operation of such business.
- 4) The affiliates agree to reimburse the Company for expenses and additional charges in accordance with schedules which are attached to the agreement. These schedules are subject to periodic amendment. Expense allocations and

other charges are determined by time, usage, and related special expense allocation studies conducted by the Company. Expenses entirely attributable to the affiliates such as printing and supplies are purchased and paid for directly by the respective affiliate.

Numerous expense categories are prorated between affiliates on Schedule A, an attachment to the agreement. Certain other expenses are allocated directly to the affiliates that benefit from expenditures. Agent's commissions are allocated 100% to the affiliate writing the business. Fixed monthly charges are paid by the affiliate for certain other expenses.

Tax Allocation Agreement

The Company and certain of its affiliates filed consolidated federal income tax returns during the examination period. The terms of the agreement for allocation of taxes are related in a resolution by the board of directors of the companies that are subject to the agreement. However, no formalized tax allocation agreement among the affiliates has been reduced to writing. Furthermore, the board resolutions do not discuss the settlement of balances between companies. SSAP No. 10, Section 12 c. requires a written income tax allocation agreement, which specifies the terms for settlement of intercompany balances, for recognition of consolidated income tax filings among affiliates.

CORPORATE RECORDS

The Company's Articles of Incorporation, By-Laws and amendments thereto were inspected and found to provide for operation of the Company in accordance with Alabama statutes and regulations and with accepted corporate practices.

Minutes of the meetings of the stockholders, board of directors and committees of the Company, from December 31, 1997 through the most recent meetings recorded at the time of examination, were reviewed. The minutes appeared to be complete and to adequately document the actions of the respective governing bodies.

MANAGEMENT AND CONTROL

Policyholders

The Company is a mutual insurance corporation with ownership vested in its policyholders. Membership in the Alabama Farmers Federation is a prerequisite for the purchase of insurance from any of the mutual insurance companies within the Alfa Insurance Group.

Board of Directors

The Company's By-Laws provide that its property and business shall be managed by a board of directors consisting of eighteen directors. Directors are elected at the annual meeting of the general membership and serve until their successors are elected and qualified. The following directors were serving at December 31, 2001:

<u>Director/Residence</u>	<u>Principal Occupation</u>
Jerry Allen Newby Athens, Alabama	Chairman of the Board, President and CEO, Company
Luther Olen Bishop Cherokee, Alabama	Farmer
John Guy Neighbors Alexander City, Alabama	Farmer
William Bert Driskell Grand Bay, Alabama	Farmer
Benjamin Philip Martin Enterprise, Alabama	Farmer
Jon Henry Miller Cottondale, Alabama	Farmer
Carl Otis Godsey Houston, Alabama	Farmer
William Townsend Kyser Greensboro, Alabama	Farmer

(continued next page)

Director/ResidencePrincipal Occupation

Ronald Gray Vaughn, II Huntsville, Alabama	Farmer
James Louis Parnell Stanton, Alabama	Farmer
Stephen Leonard Dunn Evergreen, Alabama	Treasurer, Company
Hal Franklin Lee Hartselle, Alabama	Vice President (North Area), Company
Marion Stanley Morris Ashville, Alabama	Farmer
James Albert Tolar, Jr. Marion, Alabama	Vice President (Southwest Area), Company
Russell Riley Wiggins Andalusia, Alabama	Vice President (Southeast Area), Company
Waymon Buttram Geraldine, Alabama	Farmer
Charles Clancy Turner, Jr. Black, Alabama	Farmer
Curtis Dean Wysner Woodland, Alabama	Vice President (Central Area), Company

Officers

The Company's By-Laws provide that its principal officers shall be a chairman of the board, a president, four vice presidents, a secretary, a treasurer; and, such other officers as the board of directors may determine for such terms, authority and duties as may be determined by the board of directors. Any two or more offices may be held by the same person, except the offices of president and secretary. Unless otherwise designated, the President will be the CEO.

The following officers were elected by the board of directors and were serving at December 31, 2001:

Jerry Allen Newby
Hal Franklin Lee
Russell Riley Wiggins
Curtis Dean Wysner
James Albert Tolar, Jr.
Stephen Leonard Dunn
Clyde Lee Ellis III
Herman Alan Scott

President and CEO
Vice President, North Area
Vice President, Southeast Area
Vice President, Central Area
Vice President, Southwest Area
Treasurer
Assistant Treasurer
Secretary

The following officers were appointed by the board of directors and were serving at December 31, 2001:

Clyde Lee Ellis III
Charles Wayne Hawkins
Stephen Goddard Rutledge
Herman Alan Scott
Jimmy Rogers Azar
John Thomas Jung
James Terry McCollum
Thomas Earle Byrant
Wyman Cabaniss
William Bradley Harper, Jr.
Jerry Charles Ralph
William Merit Hardy
Robert Eugene Leas
Carol Lynn Golsan
Darrell Lee McNeal
Robert Wyatt Pace
Linda Gail Harwell
Mark Clayton Campbell
Kevin Scott Lawrence
Mona Thompson Russell
Harold Ray Mann
Kenneth Everett Stephens
Elizabeth Vail Chancey
John Daryl Holley
David Ray Proctor
David Lee Hall
Walter Leonard Overby
Hudson Clayton Bush, Jr.
Thomas Allen Foster
Sandy Barnette Godwin

Executive Vice President, Operations
Executive Vice President, Marketing
Senior Vice President, CFO & Chief Investment Officer
Senior Vice President and General Counsel
Senior Vice President, IA and Planning
Senior Vice President, CIO
Senior Vice President, Claims
Senior Vice President, Human Resources
Senior Vice President, P&C Underwriting
Senior Vice President, Life & Loan Operations
Senior Vice President, Marketing, North Alabama
Senior Vice President, Marketing, South Alabama
Senior Vice President, COO, OFC Leasing
Vice President, Marketing Services
Vice President, Georgia Marketing
Vice President, Mississippi Marketing
Vice President, Auto Underwriting
Vice President, Property Management
Vice President, Office Systems
Vice President, Policy Processing
Vice President, Programming Systems
Vice President, P&C Systems Implementation
Vice President, P&C Underwriting
Vice President and Assistant CFO
Vice President, Taxes
Vice President, Special Projects
Vice President, Data Processing
Vice President, Alfa Agency
Vice President, Loan Operations
Vice President, Life Claims & Processing

(continued next page)

Kerry Horner Lashlee
 Donald Eugene Manis
 Kenneth Leonard Nelson
 Joanne Wilson
 Christine Gnann Cantrell
 Dominic Charles Labriola
 Kevin Lee Ketzler
 Alfred Edwin Schellhorn
 Harold Douglas Bowden
 Joseph Lawrence Reese, Sr.
 Jessie Eddy Mills, III
 Michael Thomas Kane
 Doug Welch
 Jeffery Furness
 Barry Wolfe
 Claudine Alan Aquillon
 Maribeth Nickell
 Robert Ernest Robinson
 Michael Stephen Morris
 Patti Jo Everage
 Michael Edward Epton
 Jacob Daniel Black
 Michael Wayne Rowell
 Connie Leah Whitecotton

Vice President, Life Underwriting/Policyowner Service
 Vice President, Property Actuary
 Vice President, Life Actuary
 Vice President, Professional Development
 Vice President, Marketing Communications
 Vice President, Advanced Sales
 Vice President, Real Estate
 Vice President, Mergers & Acquisitions
 Vice President, Management Practices
 Vice President, Information Services
 Vice President, Information Services
 Vice President, CFO, OFC
 Vice President, Business Development, OFC
 Vice President, Chief Credit Officer, OFC
 Vice President, Sales, OFC
 Vice President, Syndication/Operations, OFC
 Vice President, Marketing, OFC
 Vice President, Business Systems Development
 Vice President, Research & Development
 Assistant Vice President, Finance
 Assistant Vice President, Finance
 Assistant Vice President, Finance
 Assistant Vice President, Mergers & Acquisitions
 Assistant Vice President, Internal Audit

Committees

The following committees were appointed by the board of directors and were serving at December 31, 2001:

Contribution Committee	James Albert Tolar, Jr., Chairman Stephen Leonard Dunn Curtis Dean Wysner
Pooling Committee	Jerry Allen Newby, Chairman William Bert Driskell Luther Olen Bishop
Executive Committee	Jerry Allen Newby Hal Franklin Lee Russell Riley Wiggins

(continued next page)

Curtis Dean Wysner
James A. Tolar, Jr.
Stephen Leonard Dunn

Conflict of Interest

Conflict of interest statements executed during the examination period were reviewed through 1999. The Company's Policy Statement on Business Ethics and Conflicts of Interest, in effect prior to 2001, required all directors, officers, and employees to execute conflict of interest statements annually. Effective July 18, 2001, the Company adopted a new "Principles of Business Conduct." Because the drafting and adoption of this new policy was in process, there were no conflict of interest statements executed for the year 2000.

The new policy does not require annual conflict of interest statements. It has been amended, February 4, 2003, to incorporate the provisions required by the Federal Sarbanes-Oxley Act. Under the policy, all new employees are required to confirm their compliance with the policy at their hiring. Confirmation are obtained from all existing employees when the policy undergoes significant revision, or whenever circumstances dictate that reconfirmation would be helpful in reinforcing the Company's "tone at the top" message.

FIDELITY BOND AND OTHER INSURANCE

The Company and its affiliates were covered by a fidelity bond through the Fidelity and Deposit Company of Maryland, at December 31, 2001. This policy provided for maximum coverage of \$2,000,000, which was in excess of the \$1,750,000 amount recommended by NAIC guidelines. Nevertheless, the policy covered twenty-two named insureds which were also affiliates of the Company. The Company was the managing and employing entity for most, if not all, of these affiliates. The application of the NAIC guidelines based on the assets and income of the Company alone is deemed not to provide an adequate amount of fidelity bond coverage for all the named insureds.

It was deemed to be beyond the scope of the examination to attempt to a consolidation of the assets and income of the subject affiliates in order to arrive at an adequate amount of fidelity bond. The Company has agreed to compute the required amount of fidelity bond, based on a consolidation, and to increase its coverage accordingly.

In addition to the above, the Company had the following coverages in effect at December 31, 2001, under policies issued directly to the Company or as a named insured under policies issued to an affiliate.

Professional Liability
Boiler and Machinery
Commercial Property
General Liability
Inland Marine
Commercial Umbrella
Worker's Compensation and Employer's Liability
Business Automobile Insurance

The coverages and limits of the Company's insurance were reviewed and were deemed to adequately protect the Company's interest.

EMPLOYEE AND AGENTS' WELFARE

The Company is the employing entity for its six insurance company affiliates, by means of the Management and Operating Agreement previously discussed under the report caption, "Holding Company and Affiliates." Benefits are provided by the Company and costs are allocated to the affiliates in accordance with the terms of said agreement. The following benefits were provided to employees and agents during the examination period.

Group health care plan
Health care and/or Dependent care spending account
Long-term disability
Short-term disability
Group life insurance
Death benefit only plan
Accidental death and dismemberment insurance
Group retirement insurance policy
401k savings plan
Profit sharing plan
Deferred compensation plan
Personal leave
Maternity leave
Vacation

Benefits provided by the Company appeared to be in accordance with usual practices within the insurance industry.

REINSURANCE

Intercompany Reinsurance Pooling Agreement

This agreement was effective August 1, 1987, between the Company and its affiliates: Alfa Mutual Fire Insurance Company; Alfa Mutual General Insurance Company; Alfa Insurance Corporation; and, Alfa General Insurance Corporation. Alfa Specialty Insurance Corporation, incorporated in 1999, was added to the pool in 2001. These participants in the pooling agreement will be referred to as "the affiliates" for the remainder of this discussion. This reinsurance pooling agreement was filed with the Alabama Department of Insurance on July 29, 1987, and was subsequently approved. Pertinent terms of the agreement are as follows:

Initially, the affiliates ceded 100% of their book of business then in force to the Company and pay the Company their proportionate share of the net unearned premium less commissions at the provisional rate of 20%.

Currently, the affiliates cede 100% of the net liabilities for net premiums written and the Company retains or retrocedes the pooled business in accordance with the following percentages:

	08/01/87	10/01/94	10/01/96	01/01/01
Company	Pool 1	Pool 2	Pool 3	Pool 4
AMI	32.0	24.0	32.0	18.0
AMF	15.0	8.0	0.0	13.0
AMG	3.0	3.0	3.0	3.0
AGI	25.0	32.5	32.5	32.5
AIC	25.0	32.5	32.5	32.5
ASI				1.0

Effective November 1, 1996, the affiliates amended the agreement to include catastrophe coverage. The following percentages are shown below for the Coinsurance Allocations for Catastrophe Losses and Related Expenses for the related years:

(continued next page)

Effective November 1, 1996			Effective July 1, 1999			Effective January 1, 2001		
Cumulative Calendar Year Catastrophe Losses and Related Expenses	Coinsurance Allocation		Cumulative Calendar Year Catastrophe Losses and Related Expenses	Coinsurance Allocation		Cumulative Calendar Year Catastrophe Losses and Related Expenses	Coinsurance Allocation	
	AGI AIC	AMI AMG		AGI AIC	AMI AMG		AGI AIC	AMI, AMF, AMG, ASI
10	65%	35%	11	65%	35%	11.4	65%	35%
19	0	100%	19	0	100%	19	0	100%
32	0	100%	32	0	100%	32	0	100%
43	0	100%	43	0	100%	43	0	100%
77	0	100%	77	0	100%	77	0	100%
146	0	100%	146	0	100%	146	0	100%
198	0	100%	198	0	100%	198	0	100%
249	13%	87%	249	13%	87%	284	14%	86%
325	13%	87%	325	13%	87%	325	14%	86%
353+	13%	87%	353+	13%	87%	353+	14%	86%

- Cumulative calendar year catastrophe losses and related expenses are in millions.
- AIC and AGI to be allocated equally.
- AMI, AMF, AMG, and ASI to be allocated according to this group's relative pool percentages in effect.
- Catastrophe losses are to be accumulated during each annual calendar period.

Reinsurance Assumed

In addition to business assumed through the intercompany pooling agreement, the Company assumed reinsurance from one unaffiliated company and from two mandatory reinsurance pools.

At December 31, 2001, the Company had assumed reinsurance under approximately twenty reinsurance agreements with unaffiliated companies. All but one of these were inactive for new business. None of the reserves related to the run-off on the inactive contracts appeared to be material at December 31, 2001.

The following contract was active at December 31, 2001:

American Bankers Insurance Company - Quota Share Reinsurance Contract, effective July 1, 1995, on inland Marine and mobile Home insurance. Reinsured losses payable at December 31, 2001 amounted to \$6,015,000.

It was noted that the Company cedes 100% of its business assumed from American Bankers Insurance Company (ABIC) to Bankers Atlantic Reinsurance Company (BARC). BARC is an affiliate of ABIC. The losses ceded to BARC as of December 31, 2001 were the same as the amount of the \$6,015,000 assumption described above. The Company appears to be fronting for ABIC, in that all liabilities under the agreement are passed through to BARC and there is no transfer of risk to the Company. Because of the absence of risk transfer, these contracts do not meet the definition of reinsurance in accordance with SSAP No. 62.

See "Reinsurance Ceded" for discussion of the disallowance of credit for reinsurance Ceded relative to the contract with BARC.

Reinsurance Ceded

As of December 31, 2001, the following contracts for ceding reinsurance to nonaffiliated companies were applicable to the Company:

General Reinsurance Corporation

- Excess of Loss Reinsurance- effective January 1, 1998, on property business. The Company's retention for the first excess cover was \$500,000 and the second excess cover is \$1,000,000. The limit of liability of the reinsurer will not exceed a total payment of net loss and adjustment expense combined under the first excess cover of \$1,500,000 or under the second excess of \$3,000,000 all risks involved in one occurrence. This agreement also includes excess of loss reinsurance of liability business and insurance agents' errors and omissions business. The Company's retention is \$500,000 for the first excess cover and the second excess cover is the difference between \$2,000,000 and the sum of the indexed Company retention and the first excess cover.
- Quota Share and Excess of Loss Reinsurance of Personal Umbrella Business- effective July 1, 1998, on automobile liability, licensed recreational vehicles, uninsured/underinsured motorists coverages, business pursuits, employers liability, personal liability and unlicensed recreational vehicles and watercraft liability. In determining the Company's retention and limit of liability of the reinsurer, the limit of liability of the Company with respect to any one policy shall be deemed not to exceed \$5,000,000 each occurrence.
- Quota Share and Excess of Loss Reinsurance of Farm Personal Umbrella Business - effective July 1, 1998, on automobile liability, licensed recreational vehicles, uninsured/underinsured motorists coverages, business pursuits, employers liability, personal liability and unlicensed recreational vehicles, and watercraft liability. In determining the Company's retention and limit of liability of the reinsurer, the limit of liability of the Company with respect to any one policy shall be deemed not to exceed \$5,000,000 each occurrence.
- Quota Share and Excess of Loss Reinsurance of Commercial Umbrella Business - effective July 1, 1998, on commercial general liability, comprehensive automobile liability including hired and non-owned auto coverage and uninsured/underinsured motorists coverages, comprehensive automobile liability for school/church buses, watercraft liability, employers' liability, and professional liability. In determining the Company retention and limit of liability of the reinsurer, the limit of liability of the Company with respect to any one policy shall be deemed not to exceed \$5,000,000 each occurrence/ \$5,000,000 aggregate (where applicable).
- Quota Share and Excess of Loss Reinsurance of Commercial Umbrella Business, produced by American Direct - effective July 1, 1998, on commercial general liability,

comprehensive automobile liability including hired and non-owned auto coverage and uninsured/underinsured motorists coverages, comprehensive automobile liability of school/church buses, watercraft liability, employer' liability, and professional liability. In determining the Company retention and limit of liability of the reinsurer, the limit of liability of the Company with respect to any one policy shall be deemed not to exceed \$5,000,000 each occurrence/ \$5,000,000 aggregate (where applicable).

The following contract was with United States Fidelity and Guaranty Company 100%, prior to January 1, 2001. It had been effect since January 1, 1989. The contracts described as reinsurance the same business and are identical except for the percentage of participation by the reinsurers.

St. Paul Fire and Marine 70% -

Berkley Insurance Company 30% - Combined Catastrophe Excess of Loss Reinsurance Contract, effective January 1, 2001, on fire and allied Lines, mobile home, inland marine, automobile physical damage and the property perils only of homeowners, farmowners and commercial multiple peril. The following coverages shall apply:

- Coverage A - As respects losses arising out of occurrences commencing during the contract period commencing November 1, 1996, and each subsequent contract period, Alfa shall retain and be liable for the first \$50,000,000 of ultimate net loss arising out of each loss occurrence. The reinsurer shall then be liable for 60% of the amount by which such ultimate net loss exceeds the Company's retention, but the liability of the reinsurer shall not exceed 60% of \$10,000,000 as respects any one loss occurrence, nor shall it exceed 60% of 10,000,000 as respects any one contract period.
- Coverage B - As respects losses arising out of occurrences commencing during the contract period commencing November 1, 1996, and each subsequent contract period, the Company shall retain and be liable for the first \$60,000,000 of ultimate net loss arising out of each loss occurrence. The reinsurer shall then be liable for 50% of the amount by which such ultimate net loss exceeds the Company's retention, but the liability of the reinsurer shall not exceed 50% of \$40,000,000 as respects any one loss occurrence, nor shall it exceed 50% of \$40,000,000 as respects any one contract period.
- Coverage C - As respects any losses arising out of occurrence commencing during the contract period commencing November 1, 1996, and each subsequent contract period, the Company shall retain and be liable for the first \$150,000,000 of ultimate net loss arising out of each loss occurrence. The reinsurer shall then be liable for 75% of the amount by which such ultimate net loss exceeds the Company's retention, but the liability of the reinsurer shall not exceed 75% of \$20,000,000 as respects any one loss occurrence, nor shall it exceed 75% of \$20,000,000 as respects any one contract period.

- Coverage D - As respects losses arising out of occurrences during the contract period commencing January 1, 1998, and each subsequent contract period, the Company shall retain and be liable for the first \$100,000,000 of ultimate net loss arising out of each loss occurrence. The reinsurer shall then be liable for 16% of the amount by which such ultimate net loss exceeds the Company's retention, but the liability of the reinsurer shall not exceed 16% of \$50,000,000 as respects any one loss occurrence, nor shall it exceed 16% of \$50,000,000 as respects any one contract period.
- Coverage E - The Company shall retain and be liable for the first \$260,000,000 of ultimate net loss arising out of each loss occurrence. The reinsurer shall then be liable for 56.25% of the amount by which such ultimate net loss exceeds said retention, but the liability of the reinsurer shall not exceed 56.25% of \$24,000,000 as respects any one loss occurrence, nor shall it exceed 56.25% of \$24,000,000 as respects all loss occurrences commencing during any one contract period.

National Union Fire Insurance Company - Second Combined Excess Reinsurance Contract, effective January 1, 1993, on fire and allied lines, inland marine, and the property perils only of homeowners, mobile home, farmowners, and commercial multiple peril (including businessowners and church business). The following coverages shall apply:

- Coverage A - The Company shall retain and be liable for the first \$50,000,000 of ultimate net loss arising out of each loss occurrence. The reinsurer shall then be liable for 20% of the amount by which such ultimate net loss exceeds said retention, but the liability of the reinsurer shall not exceed 20% of \$10,000,000 as respects any one loss occurrence, nor shall it exceed 20% of \$10,000,000, as respects all loss occurrence commencing during any one contract year.
- Coverage B - The Company shall retain and be liable for the first \$60,000,000 of ultimate net loss arising out of each loss occurrence. The reinsurer shall then be liable for 8.5% of the amount by which such ultimate net loss exceeds said retention, but the liability of the reinsurer shall not exceed 8.5% of \$40,000,000 as respects all loss occurrences commencing during any one contract year.
- Coverage C - The Company shall retain and be liable for the first \$150,000,000 of ultimate net loss arising out of each loss occurrence. The reinsurer shall then be liable for 10% of the amount by which such ultimate net loss exceeds said retention, but the liability of the reinsurer shall not exceed 10% of \$20,000,000 as respects any one loss occurrence, nor shall it exceed 10% of \$20,000,000 as respects all loss occurrences commencing during any one contract year.
- Coverage D - The Company shall retain and be liable for the first \$100,000,000 of ultimate net loss arising out of each loss occurrence. The reinsurer shall then be liable for 2.4% of the amount by which such ultimate net loss exceeds said retention, but the liability of the reinsurer shall not exceed 2.4% of \$50,000,000 as respects any one loss occurrence, nor shall it exceed 2.4% of \$50,000,000 as respects all loss occurrences commencing during any one contract year.

- Coverage E - The Company shall retain and be liable for the first \$260,000,000 of ultimate net loss arising out of each loss occurrence. The reinsurer shall then be liable for 10% of the amount by which such ultimate net loss exceeds said retention, but the liability of the reinsurer shall not exceed 10% of \$24,000,000 as respects any one loss occurrence, nor shall it exceed 10% of \$24,000,000 as respects all loss occurrences commencing during any one contract year.

Tempest Reinsurance Company - Companion Excess Catastrophe Reinsurance Contract, effective January 1, 1999 and terminated December 31, 2001, both days inclusive, on fire and allied lines, inland marine and the property perils only of homeowners, mobile homeowners, farmowners and commercial multiple peril (including businessowners and church business). The following coverage applied:

	<u>Fourth Excess</u>	<u>Fifth Excess</u>
AMI Retention	\$60,000,000	\$100,000,000
Tempest Reinsurance's per occurrence limit (100% of)	\$40,000,000	\$50,000,000
Tempest Reinsurance's annual limit (100% of)	\$80,000,000	\$100,000,000

Tempest accepts 27.5% of the Fourth Companion Excess Catastrophe Reinsurance and 25% of the Fifth Companion Excess Catastrophe Reinsurance in the interests and liabilities of the Company.

Banker's Atlantic Reinsurance Company – 100% Quota Share Reinsurance Contract, effective July 1, 1995, on inland marine and mobile home business. This contract covers the business assumed from American Bankers Insurance Company. See the preceding caption, "Reinsurance Assumed," for discussion of risk transfer in regard to these two contracts.

Credit for reinsurance ceded in the amount of \$6,015,000 is deemed to be not admissible in accordance with Section 27-5-12, *Code of Alabama*, 1975. However, the amount is not deemed to be material and no related change has been made in the financial statements of this report.

All of the contracts for ceded reinsurance contained the usual insolvency clause, which provides for payments to a receiver or statutory successor without diminution, in the event of the insolvency of the ceding company.

MARKET CONDUCT

Plan of Operation

The Company markets its products through captive agents. At December 31, 2001, the Company had 394 service centers in Alabama, employing 487 agents appointed to write it business. The Company did not write business outside Alabama during the examination period, although it is licensed in several other States.

For the year 2001, private passenger automobile comprised about 78% of the Company's total business. Another 18% was comprised of homeowner and farmowner insurance. The remaining 4% was divided among several commercial and other lines of business.

The Company did not disclose any plans for acquisitions or expansion in the future.

Policy Forms and Underwriting

All the Company's active policy forms and rates in force at December 31, 2001 were found to have been approved by the Alabama Department of Insurance.

The Company filed its rates independently for its automobile, homeowner and farmowner business. ISO rates were available to the Company and were used more frequently for the lesser lines of business.

Membership in the Alabama Farmers Federation was a prerequisite to the issuance of a policy with the Company. The Company's policy is to cancel coverage when Federation membership is not renewed, except on those policies involving a real property lienholder.

Compliance With Agents Licensing Requirements

In order to verify compliance with agents licensing requirements of the Alabama Department of Insurance (ALDOI), a sample of the Company's commission payments was checked against the licensing records of the ALDOI. No discrepancies were found in the sample.

Advertising

The Company's advertising was planned and coordinated by Creative Consultants, Inc, a wholly-owned subsidiary of the Alabama Farmers Federation. The cost of advertising was shared on a proportionate basis with other participating affiliates of the Company and the Alabama Farmers Federation. Various types of advertising were utilized, such as, signs, billboards, newspaper advertisements and spot advertisements on radio and television. The Company also has a Web page (www.alfains.com), which displays the following links: Company's background, product lines, employment opportunities, agent access, how to locate an agent or the Alabama Farmers Federation and investing in Alfa stock.

The Company also maintained a cooperative advertising program with its agents. Company sponsored advertising materials were made available to the agents for their advertising purposes. Advertisement costs were shared on a 50/50 basis with the agents when the advertising was approved by the Company and paid invoices were submitted by the agent.

Claims Payments Practices

A sample of open, closed and closed without payment claim files was reviewed in order to evaluate the Company's claims payment practices. Claims were reviewed with regard to compliance with policy provisions, timeliness of payments, and adequacy of documentation.

It was noted that three of the forty-seven claims files chosen for the sample were not available for examination.

Complaints

The files of the Alabama Department of Insurance (ALDOI) were reviewed for complaints against the Company. The overall number of complaints during the examination period was deemed to be low in relation to the amount of the Company's business. However, the Company did not maintain a record of those complaints that were made directly to Company and not reported to the ALDOI.

The NAIC Market Conduct Handbook stipulates that a complaints register should include consumer direct complaints, as well as, those complaints filed with regulatory authorities.

Privacy

The Company's policy is that non-public information involving underwriting, marketing, claims handling and fraud prevention is not shared with anyone outside the Company except for that sharing allowed by the exceptions in the Gramm-Leach-Bliley Act (GLBA). The insured receives a Privacy Notice at the point of sale and the Company sends a Privacy Notice to the insured on an annual basis. The Company appeared to be in compliance with the privacy requirements of Alabama Department of Insurance, *Regulation No. 122*.

ACCOUNTS AND RECORDS

Internal Accounting Records

The Company's internal controls and information systems were evaluated by observation, by interviewing Company personnel, and by reviewing NAIC Internal Controls and Information Systems questionnaires completed by the Company. The Company's internal controls and controls over its information systems appeared to be sufficient to safeguard Company assets and to generate adequate records of its business. The Company's accounting systems and documentation of its transactions were deemed to be adequate.

The Company's internal audit department reports to management, rather than to the Audit Committee of the Board of Directors. Most of the reports generated by internal audit were concerned with agency transactions and service center accounting. Internal audit reports were made available to the examiners, but were found to be of limited usefulness for examination purposes.

External Audit and Actuarial

The Company was audited for each of the years under examination by the certified public accounting firm of KPMG, LLP. The audit reports and work papers of the external auditors were made available to the examiners, and have been utilized in the examination to the extent deemed appropriate.

The Company's reserves were certified, as of December 31, 2001, by Scott Weinstein, FCAS, MAAA of KPMG LLP, of Atlanta, Georgia.

FINANCIAL STATEMENTS

Financial statements included in this report, which reflect the operations of the Company for the years under examination and financial condition at December 31, 2001, consist of the following:

	<u>Page</u>
Statement of Assets, Liabilities, Surplus and Other Funds	25
Statement of Income	27
Reconciliation of Surplus as Regards Policyholders	28

***THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS ARE
AN INTEGRAL PART THEREOF.***

STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS

For the Period Ended December 31, 2001

ASSETS

	<u>Assets</u>	<u>Non-Admitted Assets</u>	<u>Admitted Assets</u>
Bonds	\$ 333,343,628		\$ 333,343,628
Preferred stocks	4,065,000		4,065,000
Common stocks	430,616,863		430,616,863
Real estate:			
Occupied by the Company	13,235,122		13,235,122
Held for production of income	1,848,186		1,848,186
Held for sale	270,000		270,000
Cash	12,149,336		12,149,336
Short-term investments	15,987,291		15,987,291
Other invested assets	167,704,012	\$ 11,211,301	156,492,711
Receivable for securities	59,693		59,693
Installment premium plan	8,306,234		8,306,234
Stock options owned	1,731,849	1,694,049	37,800
Agents' balances or uncollected premiums			
Premiums in course of collection	4,108,556	17,519	4,091,037
Installments booked but deferred	122,720	12,272	110,448
Funds held by reinsured companies	24,420,508	5,422,145	18,998,363
Reinsurance recoverable			
Federal income tax recoverable	5,533,491		5,533,491
Data processing equipment	21,423,959	21,423,959	
Interest, dividends and real estate income	6,154,418		6,154,418
Receivable from affiliates	33,091,114	2,412	33,088,702
Other assets nonadmitted	1,030,838	1,030,838	
Accounts receivable	464,405	376,248	88,157
Commercial audit premiums	222,944	153,710	69,234
Prepaid expenses	3,377,256	3,377,256	
CSV - employee DBO plan	68,692,512		68,692,512
Rounding	(4)		(5)
Total Assets	<u>\$ 1,157,959,931</u>	<u>\$ 44,721,709</u>	<u>\$ 1,113,238,221</u>

STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS (continued)

LIABILITIES SURPLUS AND OTHER FUNDS

Liabilities

Losses (<i>Note - 1</i>)	\$ 71,873,444
Loss adjustment expenses (<i>Note - 1</i>)	11,357,612
Other expenses	5,959,717
Taxes, licenses and fees	303,454
Federal income taxes	98,798,100
Borrowed money	723,266
Unearned premiums	58,592,497
Funds held by Company under reinsurance treaties	59,957,958
Amounts withheld or retained for account of others	35,363,844
Drafts outstanding	20,970,437
Payable to affiliates	7,514,208
Option liabilities	376,275
Reserve for premium ceded	9
Reserve for advance premium	6,635,964
Reserve for premium deficiency (<i>Note - 2</i>)	<u>482,169</u>
Total liabilities	\$ 378,908,954

Surplus and Other Funds

Partnership capital commitment - special surplus	\$ 9,914,811
Unassigned funds (surplus) (<i>Note - 3</i>)	<u>724,414,456</u>
Surplus as regards policyholders	<u>734,329,267</u>
Total liabilities, surplus and other funds	<u>\$ 1,113,238,221</u>

STATEMENT OF INCOME

For the Periods Ended,

	December 31, 2001	December 31, 2000	December 31, 1999	December 31, 1998
Underwriting income:				
Premiums earned	\$ 98,593,089	\$ 169,395,912	\$ 165,019,029	\$ 175,846,593
Deductions:				
Losses incurred	\$ 77,708,199	\$ 132,082,490	\$ 109,846,777	\$ 153,633,073
Loss expenses incurred	3,146,714	9,151,785	8,865,346	8,540,013
Other underwriting expenses incurred	31,031,115	54,165,552	48,090,854	50,210,686
Total deductions	\$ 111,886,028	\$ 195,399,827	\$ 166,802,977	\$ 212,383,772
Net underwriting gain (loss)	\$ (13,292,939)	\$ (26,003,915)	\$ (1,783,948)	\$ (36,537,179)
Investment income:				
Net investment income earned	\$ 40,702,476	\$ 51,075,967	\$ 45,581,224	\$ 39,450,852
Net realized capital gains (losses)	38,694,755	(2,006,360)	25,230,892	18,063,382
Net investment gain (loss)	\$ 79,397,231	\$ 49,069,607	\$ 70,812,116	\$ 57,514,234
Other income:				
Finance and service charges not included in premiums	\$ 1,461,799	\$ 2,352,275	\$ 1,924,070	\$ 1,986,796
Miscellaneous income	4,956,747		528,000	
Total other income	\$ 6,418,546	\$ 2,352,275	\$ 2,452,070	\$ 1,986,796
Net income before dividends and taxes	\$ 72,522,838	\$ 25,417,967	\$ 71,480,238	\$ 22,963,851
Dividends to policyholders	(120,097)	9,867,427		(568,176)
Federal income taxes	4,794,125	3,146,715	8,968,909	5,972,962
Net income	\$ 67,848,810	\$ 12,403,825	\$ 62,511,329	\$ 17,559,065

RECONCILIATION OF SURPLUS AS REGARDS POLICYHOLDERS

For the Periods Ended December 31,

	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>
Surplus as regards policyholders, January 1,	\$ 782,512,414	\$ 770,390,410	\$ 782,352,271	\$ 729,068,261
Net income	\$ 67,848,810	\$ 12,403,825	\$ 62,511,329	\$ 17,559,065
Net unrealized capital gains or (losses)	(16,144,808)	12,946,453	(60,542,727)	33,829,183
Change in net deferred income tax	(12,915,345)			(526,551)
Change in non-admitted assets	(4,133,240)	(11,304,448)	(13,044,816)	213,000
Change in provision for reinsurance			(1,827,258)	(636,015)
Change in excess of statutory reserves		(3,013,666)		
Cumulative effect of changes in accounting principles	(83,936,539)			171,135
Direct entries to surplus	(80,973)	109,215	(766,835)	2,674,193
Adjustment in prior year income tax liability	1,029,174	980,625	1,708,445	
Prior year premium tax	149,781			
Rounding	(8)		1	
Change in surplus as regards policyholders	\$ (48,183,148)	\$ 12,122,004	\$ (11,961,861)	\$ 53,284,010
Surplus as regards policyholders, December 31,	\$ 734,329,266	\$ 782,512,414	\$ 770,390,410	\$ 782,352,271

NOTES TO THE FINANCIAL STATEMENTS

Note 1 – Losses

Loss Adjustment Expenses

\$71,873,444

\$11,357,612

The amounts of the captioned liabilities are the same as the amounts reported in the Company's 2001 Annual Statement. However, the amounts per examination differed as follows. The amount of losses determined per examination was \$67,856,000, or \$4,017,444 less than the amount reported. The amount of Loss Adjustment Expenses (LAE) determined by examination was \$8,675,000, or \$2,682,612 less than the amount reported. The total examination difference is \$6,700,056, and is not material for the purposes of this report. Therefore, no related changes have been made to the financial statements contained herein. These examination differences were developed by the actuarial examiners, and were based on the following findings.

In the opinion of the actuarial examiners, the 2001 Annual Statement reserves were reasonably conservative given the information available at year-end 2001. However, the range of possible outcomes becomes narrower with the passage of time. Given actual development through year-end 2002, it is the opinion of the actuarial examiners that the 2001 Annual Statement reserves are outside the range of reasonable reserves. Therefore, adjustments are recommended for examination purposes. Consistent with the requirements for the statutory actuarial reserves opinion, the examination reserves must be within the range of reasonable reserves defined by the independent actuarial analyses of the actuarial examiners.

Company management explained that the approximate 85th percentile confidence level was targeted at year-end 2001, in order to book reserves at a conservative level. Company management stated that they wished to book reserves at a level where favorable development is more likely than adverse development. SSAP #55, paragraph 10 states that management shall record their best estimate of liabilities for unpaid losses and LAE. Upon detailed review of this guidance, it was determined that the NAIC did not intend this to be a strict guidance. It was determined that reasonably conservative reserve levels should not be specifically prohibited in the consideration of management's best estimate.

It was also the opinion of the actuarial examiners that the reserve redundancy was partially due to the data used to calculate defense and cost containment (DCC) reserves. Both the Company's actuary and the opining actuary relied upon an inconsistent mix of allocated loss adjustment expenses (ALAE) and DCC data in their respective reserve analyses. These actuaries were aware of the inconsistencies and attempted to judgmentally adjust their selections accordingly. In the opinion of the actuarial examiners, those adjustments were subjective. The results of the examination

reserve analyses, which used DCC-only data in the projection of DCC reserves, imply that the booked DCC reserves were conservative.

Note 2 – Premium Deficiency Reserve

\$482,169

The amount of the captioned liability is the same as reported in the Company's 2001 Annual Statement. The actuarial examination of this reserve determined that it was not necessary and that the amount per examination was \$-0-. The difference is not deemed to be material and no related change has been made in the financial statements of this report.

Premium deficiency reserves (PDR) in the aggregate amount of \$1,691,314 were calculated for the participants in the reinsurance pool. The aggregate PDR was allocated to each company based on the pooling percentages (including catastrophe-layer pooling) in effect at year-end 2001. The resulting PDR for the Company was \$482,169. See the report caption "Reinsurance" for details of the Company's participation in the reinsurance pool.

PDR liabilities are relatively rare for insurance companies writing standard personal lines insurance products. Since PDR is a relatively new item in statutory accounting, the Company's actuaries did not have significant historical guidance in establishing the PDR methodology. Therefore, they applied judgment, tempered with conservative assumptions to estimate PDR reserves. The actuarial examiners reviewed the assumptions and provided additional guidance relating to the PDR calculation. Some of the assumptions that contributed to the conservative results are briefly discussed as follows:

- The Company assumed that none of the other acquisition or general expenses are paid at or before policy inception. It is more common to assume that all of other acquisition expenses and a portion of general expenses are paid at or before policy inception.
- The PDR calculation incorporated discounting of losses and LAE for one-half of a year, whereas anticipated incurred losses could be discounted to the expected loss payment date. The discounting calculation assumed that all general expenses and other acquisition expenses are pre-paid. That assumption is inconsistent with the assumption listed above.
- The PDR calculation was conducted separately for each line of business for each direct book of business. The Company should have combined products that are marketed together and combined for profitability analysis. For instance, it is common to assume that auto liability and physical damage products are marketed on a combined basis.

The actuarial examiners conducted independent analyses of PDR, resulting in no indicated liability related to net unearned premiums as of year-end 2001.

Note 3 – Unassigned Funds (surplus)

\$724,414,456

The amount of unassigned funds per examination is the same as reported in the Company's 2001 Annual Statement. Variances in account balances determined by the examination were deemed to be immaterial in the aggregate amount.

CONTINGENT LIABILITIES AND PENDING LITIGATION

The examination for contingent liabilities and pending litigation included review of the Company's Annual Statement disclosures, minutes of the corporate governing bodies, pending claims, and the usual examination of the accounts for unrecorded items. No material unreported contingencies were noted and all litigation pending against the Company, at December 31, 2001, appeared to be within the ordinary course of its business.

It was noted that the Company reported the following material contingency in its 2001 Annual Statement, Notes to the Financial Statement. In February of 1995, the Company agreed to guarantee the payment of principal plus accrued and unpaid interest to the owners of commercial paper issued by Alfa Corporation, an affiliate. The guarantee cannot at any one time exceed \$150,000,000 of principal plus any accrued interest. As of the date of this report there had been no calls against this guarantee.

The Company's Chief Executive Officer and its Chief Financial Officer executed a letter of representation, attesting to the non-existence of unreported liabilities and contingencies as of December 31, 2001.

SUBSEQUENT EVENTS

The review of events subsequent to December 31, 2001 and up to the date of this report included: review of the Company's 2002 Annual Statement; review of cash disbursements through December 31, 2002; review of corporate records through October of 2003; and, inquiries of Company management. No subsequent events were identified that were deemed to have an impact on this examination; and, no subsequent events were identified that might potentially have a material impact on the Company's continued operations and/or financial condition.

COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

It appeared that the Company had complied with all recommendations made as a result of the examination report as of December 31, 1997, except for the recommendation relating to fidelity bond coverage. See "Comments and Recommendations, Fidelity Bond and Other Insurance," which follows for the current recommendation.

COMMENTS AND RECOMMENDATIONS

Holding Company and Affiliates – Agreements with Affiliates – Page 7

It is recommended that the Company, and the affiliates with which it files consolidated federal income tax returns, develop a written tax allocation agreement, which specifies the terms for the settlement of intercompany balances, in compliance with SSAP No. 10, Section 12 c.

Management and Control – Conflict of Interest – Page 13

The Company's conflict of interest policy was changed during the examination period, and subsequently amended to add the requirements of the Federal Sarbanes-Oxley Act. Annual reporting requirements have been eliminated under the new policy.

Fidelity Bond and Other Insurance – Page 13

The Company's fidelity bond coverage was found to be inadequate to cover the Company and twenty-two affiliates that are named insured on the policy. The Company has agreed to compute the required amount of coverage based on a consolidation of the assets and income of all the named insureds, and increase its coverage accordingly.

It is noted that the examination of the Company as of December 31, 1997 also found the amount of the Company's fidelity bond to be inadequate.

Reinsurance Assumed / Reinsurance Ceded – Page 16

The Company is advised that its contracts with American Bankers Insurance Company and Bankers Atlantic Reinsurance Company do not meet the definition of reinsurance as stated in SSAP No. 62.

It is recommended that the Company cease taking credit for reinsurance ceded to Bankers Atlantic Reinsurance Company, in compliance with Section 27-5-12, *Code of Alabama*, 1975.

Market Conduct - Claims Payment Practices – Page 22

It is recommended that the Company maintain complete and accurate records with regard to its claims files, in accordance with Section 27-27-29, *Code of Alabama*, 1975.

Market Conduct – Complaints – Page 22

It is recommended that the Company maintain a complaints register that includes all complaints received, rather than just those that are filed with regulatory agencies.

Losses & Loss Adjustment Expenses – Page 29

The loss and LAE reserves reported in the Company's 2001 Annual Statement were found to meet the requirements of SSAP #55, at the time said reserves were reported. Based on development through year-end 2002, said reserves were not within a reasonable range; however, the differences were not deemed to be material and no related changes have been made in the financial statements of this report.

Premium Deficiency Reserve – Page 30

The Company's PDR liability has been adjusted to zero for examination purposes. It is recommended that the Company re-evaluate its PDR calculations and assumptions for future analyses, and statutory reporting purposes.

CONCLUSION

Acknowledgement is hereby made of the courtesy and cooperation extended by representatives of **Alfa Mutual Insurance Company** during this examination.

The customary examination procedures, as recommended by the National Association of Insurance Commissioners, have been followed to the extent appropriate in connection with the verification and valuation of assets and the determination of liabilities set forth in this report.

Examination findings indicated that the Company was in sound financial condition as of December 31, 2001.

In addition to the undersigned, the following persons represented the Alabama Department of Insurance as participants in this examination: Palmer W. Nelson, AFE, Douglas T. Brown, Thomas W. Salo, Theophilos C. Goodin, Deanne Brown, Larae Mason and Bobby Mckinnon, examiners; Glenn Taylor, ACAS, MAAA, and Randall D. Ross, actuarial consultants.

Respectfully submitted,
February 20, 2004



Rex H. Newborn, CFE
Examiner-in-Charge
Alabama Department of Insurance

**EXAMINER'S AFFIDAVIT AS TO STANDARDS AND PROCEDURES
USED IN AN EXAMINATION**

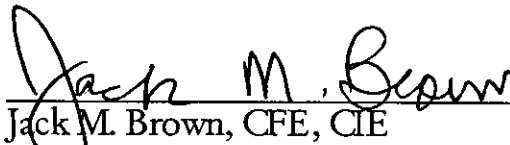
STATE OF ALABAMA

COUNTY OF MONTGOMERY

Jack M. Brown, being duly sworn, states as follows:

1. I have authority to represent the State of Alabama in the examination of Alfa Mutual Insurance Company, Montgomery, Alabama.
2. The Alabama Department of Insurance is accredited under the National Association of Insurance Commissioners Financial Regulation Accreditation Standards.
3. I have reviewed the examination workpapers and examination report, and the December 31, 2001 examination of Alfa Mutual Insurance Company, Montgomery, Alabama was performed in a manner consistent with the standards and procedures required by the State of Alabama Department of Insurance, and the National Association of Insurance Commissioners.

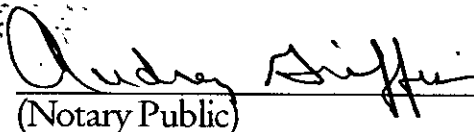
The affiant says nothing further.



Jack M. Brown, CFE, CIE
Assistant Chief Examiner, and Insurance Examinations Supervisor
State of Alabama, Department of Insurance

Subscribed and sworn before me by Jack M. Brown on this 16th day of July, 2004.

(SEAL)



(Notary Public)

My commission expires

11/2/05
(Date)